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Microinsurance Innovations in Rural Finance

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Poor people in developing countries are vulnerable to a broad range of shocks that affect their livelihoods, including illness, accidents, and death as well as loss of assets such as animals, crops, and machinery. The poor are still predominantly rural, and their vulnerability is even higher than that of their urban peers. Health facilities are less available and less well equipped in rural areas; water, sanitation, roads, and telecommunication are less developed; and people are less educated and not as aware of risk-mitigation mechanisms. Given the rural character of poverty in many countries, poverty reduction remains strongly connected to agricultural development, and sustainable agricultural development depends on well-organized risk mitigation. One important tool for mitigating risk is microinsurance.

The International Association of Insurance Supervisors (IAIS) defines microinsurance as "insurance that is accessed by the low-income population, provided by a variety of different providers but run in accordance with generally accepted insurance practices (including the IAIS Insurance Core Principles)." It differs from traditional insurance in that it is adapted to the circumstances of the poor: premiums are low, products have simple designs, it is offered through well-trusted and innovative channels, premium payments are flexible, and claims are settled promptly.

Microinsurance has the potential to enable the rural poor to mitigate the effects of shocks that threaten their lives, productivity, and assets. It can help prevent emergencies from depleting poor people's savings and other assets. Furthermore, it allows households to invest in high-risk, high-return activities by securing the lending risk for agricultural and other investments.

Financial sector reforms in many countries have begun to include insurance as an important pro-poor financial service along with other microfinance services such as savings, lending, and cashless payments. According to a study by the International Labour Organization, microinsurance in Africa almost doubled from 2006 to 2009. The survey shows that half of the schemes were growing faster than 30 percent a year between 2007 and 2008. Data on growth in rural areas, however, are not available.

Microinsurance in rural areas

Providing microinsurance in rural areas can be more difficult than in urban settings and requires some adaptations in terms of insurance products, risk carriers, delivery, and servicing. The characteristics of its market make sales and pricing more difficult. Because educational levels are usually lower in rural areas, low-income households' financial capability is weaker. Potential customers often distrust insurance. Affordability is another challenge because rural people rely on seasonal and generally low incomes. Demand is not known or understood, products are poorly designed, and if microinsurance is available at all, the selection of policies is limited. Systems are not adapted to manage many small transactions for premium collection, back-office administration, and claims management. Population density is often low and distances are far, making it more difficult to reach scale. Distribution can suffer from the lack of channels like banking outlets. Risk assessment is difficult because of a lack of mortality and morbidity data. All these factors make underwriting more expensive, and therefore, the mostly urban-based insurers are not ready to serve rural low-income markets. Rural providers are often small and informal, with the inherent challenges of such organizational forms, such as weak governance or limited range of products.

Experiences in providing microinsurance to the rural poor

Some microinsurance schemes tailored to rural areas provide useful lessons. For example, a pilot project in India, set up by the microfinance institution BASIX and a commercial insurer with the help of the World Bank, has been providing weather insurance for small farmers to improve their access to credit. This microinsurance scheme is based on a rainfall index. Payments are based not on individual loss adjustments—a costly undertaking not feasible in microinsurance—but rather on whether rainfall measured at a local weather station reaches a certain threshold. The insurance contracts are linked to credit because the insurance secures repayment of the loans.

At the outset, the project had to solve several problems like poor-quality weather data. Furthermore, the insurance provider strongly focused on raising awareness, capacity building, continuous product improvement, and quick payouts. Certain elements remain unresolved, such as basis risk (which occurs when the actual loss does not match the benefit because a payout is triggered but there is no loss or vice versa), high premiums, clients' difficulties understanding this complex product, and low demand due to these factors. Nevertheless, the Indian weather insurance market is growing strongly, and new microinsurance providers are entering the market.

Innovations are also taking place in the policy area. Insurance regulators across the globe are working to create an enabling framework for insurance products, delivery channels, and new providers. Brazil and Ghana are among the countries changing their regulations, and South Africa aims to integrate thousands of existing informal burial societies into the mainstream insurance sector.

The Philippines has already made such a regulatory move. In 2006 the Insurance Commission of the Philippines issued Insurance Memorandum Circular No. 9-2006, which provided a definition of microinsurance and spelled out the requirements for registering a microinsurance mutual benefit association. As a result, by the end of 2009, microinsurance mutuals covered 2 million policyholders. Now the Philippine government is pursuing a wider approach that aims to increase access to microinsurance products and services by including different kinds of actors. The country's National Microinsurance Strategy and regulatory framework focus on increasing private-sector participation in the provision of microinsurance and the mainstreaming of informal insurance.

Another groundbreaking example of dedicated microinsurance regulation can be found in India. India was the first country to pass regulations covering microinsurance products and agents in 2005. In addition, India made it compulsory for all insurers to provide microinsurance to the rural and social sectors (the "social sector" includes the unorganized sector, informal sector, economically vulnerable or backward classes, and other categories of persons in both rural and urban areas).

Although the evidence on requiring insurers to provide microinsurance is mixed (as insurers may consider the penalties a cost of doing business), this approach has stimulated a large number of pilot projects and provided useful lessons for the industry and for policymakers.

Today, insurance supervisors all over the world are expressing strong interest in sharing experiences and understanding the dynamics of an enabling regulatory and policy environment. In response to this interest, the IAIS, in partnership with the Consultative Group to Assist the Poor, the International Labour Organization, the German Federal Ministry for Economic Cooperation and Development, and Finmark Trust, created the global "Access to Insurance Initiative" (www.access-to-insurance.org) to foster capacity development and standard setting for insurance supervisors.

Key challenges for the development of microinsurance markets in rural areas

Much has been learned about developing effective and broad-based microinsurance markets in the past few years, but a number of challenges still face efforts to extend microinsurance in rural areas:

1. The strategy and policy challenge: A holistic approach to improving the financial system addresses the actors on three levels: it focuses simultaneously on framework conditions involving sector strategies, regulation, and supervision (macro level); service providers and public goods (meso level); and insurers, intermediaries, and customers (micro level). Rural development policies and financial sector development policies need to include microinsurance, and public resources need to be made available.
2. The underwriting challenge: Underwriting in rural areas faces higher risks and weaker infrastructure, which requires special attention from policymakers and development organizations. Community-based and mutual types of underwriters are more common in rural areas than in urban areas, and they often require institution-building support. International development cooperation agencies can help by supporting capacity building and investment.
3. The delivery challenge: Delivery channels that are close and easy to use and support rural delivery need to be strengthened. These channels can include cell-phone banking and retail shops. Community-based organizations play an important role in providing microinsurance in rural areas, and these organizations are often the risk carriers. This situation is suboptimal because of their limited reserves and management skills. Converting them from insurers to delivery channels could mitigate many of these problems.
4. The consumer challenge: Consumer-related challenges, such as affordability, insurance literacy, and consumer protection, need a special look. Affordability is more sensitive in rural areas than in urban areas because rural residents face higher cash-flow fluctuations in agriculture and generally have lower incomes. More investments are needed in insurance literacy. Consumer protection is a greater challenge in rural areas because the ombudsman and courts are often far away, and a claimant needs to finance travel costs.
5. The support structure challenge: Service providers in microinsurance are often not active in rural areas and not equipped to transfer the required know-how and systems to their clients, the intermediaries, and insurers. Training courses for rural staff of insurers are more costly to organize. Service providers often face higher costs to assess demand or establish risk data for remote areas and therefore neglect rural areas.
6. The agricultural insurance challenge: Although index insurance can potentially overcome many of the problems associated with traditional insurance, it requires improving the availability of high-quality weather data, creating awareness among farmers, achieving quick payouts, and dealing with basis risk due to conditions that might affect farmers but are not incorporated in the index (such as soil composition or uneven terrain).

Conclusion

Rural microinsurance products and their sales strategies require huge investments in product innovation, literacy work, and establishment of sound providers and intermediaries. In addition, regulatory dedication and innovation are required to spur the provision of rural microinsurance by motivating and formalizing rural providers and developing adequate customer protection.

Microinsurance is an integral part of the financial sector and should be promoted as such, through an "access to finance strategy." Rural finance and rural development policies should explicitly deal with microinsurance, including agricultural microinsurance. Coherence with other sector policies—such as agricultural development policy, social security policy, or consumer protection policy—results in more effective approaches. ■

For further reading: German Federal Ministry for Economic Cooperation and Development (BMZ), *Security at Little Cost: Microinsurance in Financial Systems Development* (Bonn, 2009), www.bmz.de/en/service/infothek/fach/konzepte/konzept179.pdf; Lloyd's and the Microinsurance Centre, *Insurance in Developing Countries: Exploring Opportunities in Microinsurance* (London and Appleton, WI, 2009); M. Mc-Cord and J. Roth, *Agricultural Microinsurance: Global Practices and Prospects* (Appleton, WI: Microinsurance Centre, 2008), www.microinsurancecentre.org/UI/DocAbstractDetails.aspx?DocID=660.

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